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EU CAP Reform deal approved

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Report Highlights:
EU Agriculture Ministers agreed to a CAP reform compromise early in the morning on Thursday, June 26. The complex compromise includes partial decoupling, cuts in dairy intervention prices and several other provisions of interest to the US agriculture sector.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Brussels USEU [BE2]
[E2]

Summary: After a three-week marathon of discussions, Agriculture Ministers reached a political agreement on CAP reform at 7:30 am in Luxembourg today. The final compromise is highly complex and represents a significant watering-down of the original Commission proposals. Decoupling of payments from production can be delayed until 2007 at Member States' discretion and several payments may be kept partially or wholly coupled. While price cuts for the cereals sector were scrapped, limited cuts were introduced in the dairy sector. The Commission and Member States have hailed the deal as "historic" and called it Europe's "important contribution to the Doha Development Agenda." Significantly, the compromise text states that the EU "will not pay twice in order to conclude the round," meaning that they do not intend to make further concessions in the WTO agriculture negotiations beyond what they have agreed to in the reform.

See GAIN report E23085 for an overview of the reform proposals compared to the current CAP programs.

Decoupling

The Commission had originally proposed to "decouple" direct aids currently paid to farmers in mainly the arable crops and livestock sectors. These direct aids are paid to farmers to compensate them for price cuts for these commodities under the MacSharry and Agenda 2000 reforms (for this reason, they were once called "compensatory payments"). Decoupling the aids would shift the support from the "blue" to the "green" box in WTO terms (see GAIN report E23096 for an overview of the WTO Agreement on Agriculture). Farmers would receive the aids based on historical production during a reference period (2000-2002) and would have no obligation to produce specific crops to receive the payments. Most other specific payments in these sectors were also proposed to be included in the new decoupled "Single Farm Payment." Other sectors, such as sugar or wine were not included in the decoupling proposal and are expected to be reformed at a later date.

Note that farmers receiving the decoupled payments would not be able to grow perennial crops, fruits and vegetables, ware potatoes or any crop for which they receive payments under certain sectors which have not yet been reformed or for which there are restrictions on new plantings (olive oil, wine, etc), yet they must maintain their land in "good agricultural condition." In practice, this means that they must continue producing something and most likely will continue producing what they have historically produced, given that their other options are limited. In addition, for the partially-decoupled sectors, farmers will still need to produce a specific crop to get the production-linked portion of the payment.

The complexity of today's compromise on decoupling demonstrates the high level of controversy surrounding this issue among the Member States. It is best summarized as falling into three categories: payments that will not be decoupled at all, payments that will be partially decoupled and payments that will be decoupled later.

Some payments will **not be decoupled**, including seeds payments, drying aid for cereals, and direct aids in outermost regions. Payments for the durum wheat quality premium, protein crop supplement, crop-specific payments for rice, flax, hemp linseed, potato starch processing and dried fodder processing were never proposed to be decoupled in the first place. A new production-linked aid has also been introduced to support the production of energy crops. A per-hectare aid to support nut production has also been introduced.

Some payments will be **partially decoupled**. The compromise leaves Member States flexibility to choose whether or not to fully decouple certain payments. They may fully decouple, or they may choose between leaving up to 25% of the per hectare payments for **arable crops** linked to production or up to 40% of the supplementary durum wheat premium. For the **beef sector**, they may choose between leaving up to 100% of the suckler cow premium and 40% of the slaughter premium linked to production as well as either 100% of the slaughter premium or 75% of the special male premium. Up to 50% of **sheep and goat** premia, including the supplementary premium for Less Favored Areas can remain coupled. The partial decoupling options can be applied at a regional level.

Some payments will be **decoupled later**. While the overall decoupling scheme is set to go into effect in 2005, Member States may decide to delay implementation until 2007. **Dairy** payments will only be decoupled starting in 2008 although Member States may decide to introduce decoupling earlier. The Commission may take further steps through its management committee procedure to avoid distortions in competition and to "ensure respect of international obligations."

Intervention price cuts

For **cereals**, the Commission originally proposed to implement the final 5% intervention price cut for cereals as had already been agreed under Agenda 2000, abolish the monthly increment, and exclude rye from the intervention system. Under the final compromise, the cereals intervention price will not be cut, the monthly increment will be reduced by 50% and rye will be excluded from intervention. As the rye measure will have the biggest impact on Germany, a concession was made to allow Germany to retain 90% of money saved through modulation and to spend at least 10% of this money in rye-producing regions.

For **rice**, the Commission proposed a two-stage system for intervention whereby a private storage mechanism would be triggered when prices reach 150 Euros/ton and intervention would remain only as a safety net when prices reach 120 Euros/ton. Under the compromise, the private storage concept was abandoned and intervention will be triggered at 150 Euros/ton but will be limited to 75,000 tons per year.

For **dairy**, the Commission proposed to phase in price cuts of 35% for butter and 17.5 % for skimmed milk powder. Intervention for butter was to be limited to 30,000 tons per year. Under the compromise, butter intervention prices will be cut by 25% and skimmed milk powder by 15%. This represents only a 10% higher cut for butter than was already planned under Agenda 2000 and no additional cut for skimmed milk powder. Butter intervention will be limited to 70,000 tons in 2004 dropping to 30,000 tons by 2007.

Set-aside

Farmers who receive a component of the Single Farm Payment based on historical set-aside (ie. who have a set-aside entitlement) would continue to have a set-aside obligation. The Commission originally proposed to make this set-aside long-term and non-rotational. Under the final compromise, set-aside will remain rotational and farmers will be able to grow industrial crops on it (as is currently the case). The Commission also noted however that they may need to apply further set-aside obligations to land sown with cereals and oilseeds.

Rice Article 28

The compromise includes a mandate for the Commission to conduct Article 28 negotiations with WTO trading partners to modify the bound tariffs for rice. The mandate states that the Commission will propose that the current bound specific duties for rice under tariff headings 100620, 100630, tariff quotas under these headings and Headnote 7 of the EC's WTO schedule (the Margin of Preference for rice), be "supplemented" by a more stable and predictable import regime. The final compromise differs from earlier versions with the addition of a sentence saying that "the Commission will also take into account the interest of developing countries, including those of traditional suppliers, as well as the implementation of the "EBA" regulation." It also notes that "new tariff items could be created by means of a breakout from an existing tariff line."

Modulation

Modulation refers to the gradual reduction of the overall level of the single farm payment (direct aids). The Commission's proposals called for the modulation rate to rise to 19% by 2012, of which 6% would go to financing rural development and the rest would have been used to finance further reforms of the CAP, for example the sugar sector.

Under the final compromise however, modulation will only shift funds into rural development. Starting in 2005, payments will be reduced by 3% per year, rising to 5% in 2005. The first EUR 5,000 of a farmer's direct payments will be exempted from modulation as will the 'outermost' regions, such as some of the Greek islands.

The money thus saved will be channeled to increased rural development spending. The Commission estimates that eventually EUR 1.2 bn per year, will be moved into rural development each year.

Of the funds moved into the rural development budget by modulation the first one per cent will be spent in the Member State where the modulation took place and the remainder will be divided amongst all the Member States on the basis of agricultural area and employment as well as GDP per capita. However, each Member State is guaranteed to receive at least 80% of its modulation funds in return, and 90% in the case of Germany to compensate for the elimination of rye intervention.

Budget year	2005	2006	2007	2008 to 2013
Farms with up to € 5 000 direct payments a year	0%	0%	0%	0%
Above € 5 000	3%	4%	5%	5%

Financial stability (formerly known as "degressivity")

The financial stability proposal is effectively a budget ceiling on CAP expenditure. When CAP expenditure is forecast to come to within EUR 300m of the ceiling, all direct payments will be cut on a pro-rata basis to ensure that the ceiling is not exceeded. The EUR 300m buffer provides a security margin.

In more detail, CAP expenditure is defined as subheading 1a in the EU budget. This covers market expenditure (market support and direct payments). It is currently around EUR 43 bn per year. Heading 1b covers rural development and accounts for roughly EUR 4.5 bn of EU expenditure.

Any reductions in direct payments due to the financial stability requirements will require agreement from the Council based on a Commission proposal. An exemption for the first EUR 5,000 of direct payments, similar to the modulation rules will also be applied. There is scope left in the proposals for this exemption to be increased should the financial stability rules be called into force.

Cross-compliance

Following the introduction of the single payment, farmers will be required to meet certain environmental, food safety, animal and plant health and animal welfare standards. Additionally, farmers will be required to keep farmland in "good agricultural and environmental condition". These are the two features of cross-compliance. As a result of failure to meet the standards, direct payments could be reduced. The Member State would be entitled to retain 25% of any reductions, the rest returning to the EU's coffers.

Further details, timetabling and coverage of the cross compliance rules will only be known once the Commission publishes a working paper. The paper will also define the indicators to be used to meet the cross compliance conditions. It is expected that they will focus primarily on maintaining land in good agricultural condition.